

## Message Text

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ACTION EUR-12

INFO OCT-01 ISO-00 SP-02 AID-05 EB-08 TRSE-00 SS-15  
STR-07 OMB-01 CEA-01 CIAE-00 COME-00 FRB-03  
INR-10 NSAE-00 XMB-02 OPIC-03 LAB-04 SIL-01 L-03  
H-01 PA-01 DOE-11 SOE-02 DOEE-00 DODE-00 NSCE-00  
SSO-00 USIE-00 INRE-00 /093 W  
-----045725 181525Z /40/43

O R 171552Z MAR 78  
FM AMEMBASSY LONDON  
TO SECSTATE WASHDC IMMEDIATE 4253  
INFO AMEMBASSY PARIS  
AMEMBASSY BONN  
AMEMBASSY BRUSSELS

C O N F I D E N T I A L SECTION 01 OF 03 LONDON 04312

USOECN ALSO FOR EMBASSY

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C O R R E C T E D C O P Y (TEXT)

E.O. 11652: GDS  
TAGS: EGEN, PINT, UK, EFIN  
SUBJECT: ECONOMIC CHANGES ALTER POLITICAL MOOD

REF: LONDON 1893

1. SINCE THE BEGINNING OF THIS YEAR THERE HAS BEEN IN-  
CREASING SOBRIETY IN BRITISH ASSESSMENTS OF THE PRO-  
SPECTS FOR THE UK ECONOMY. THE PAST SIX WEEKS HAVE  
SEEN (A) FURTHER DARKENING OF THE TONE OF PRESS  
OBSERVERS AND (B), AMONG POLITICIANS, AN ACCENTUATED,  
AND RELATED, CONCERN ABOUT THE PROSPECTS FOR THE  
WORLD ECONOMY AND ITS IMPLICATIONS FOR BRITAIN. IN  
REFTEL WE SAID "THE EUPHORIA...IS ABATING AND MOVING  
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TOWARD A MORE REALISTIC APPRECIATION OF THE SITUATION."  
THIS PROCESS HAS CONTINUED.

2. THE IMMEDIATE CAUSE OF THE INCREASED CONCERN SEEMS,  
AS FREQUENTLY IN THE PAST, TO HAVE BEEN THE PUBLICATION  
OF UNFAVORABLE ECONOMIC INDICATORS. A CLUTCH OF INDICE  
SUGGESTING THAT BRITAIN'S INTERNATIONAL COMPETITIVENESS

IS AGAIN ERODING WAS ISSUED BY HM TREASURY AT THE BEGINNING OF FEBRUARY, CLOSELY FOLLOWED BY THE UNEXPECTEDLY POOR JANUARY TRADE FIGURES. AT THE SAME TIME, PROSPECTS FOR ECONOMIC GROWTH IN OTHER COUNTRIES - AND CERTAINLY FOR ADDITIONAL GROWTH IN THE "LOCOMOTIVE" ECONOMIES - WERE PERCEIVED TO BE POOR. OBSERVERS LINKED THE INDICES TOGETHER. THEY SUGGESTED THAT WITH WORLD TRADE SHOWING SIGNS OF SLOW GROWTH AS A RESULT OF SLUGGISH ECONOMIC RECOVERY, BRITAIN'S EXPORT PROSPECTS WOULD BE MODEST, EVEN IF THE STRENGTHENING OF THE POUND AND CONTINUED INFLATION DO NOT DAMAGE BRITISH COMPETITIVENESS. ON THE IMPORT SIDE, THE EXPERIENCE OF THE PAST FEW YEARS SEEMS TO INDICATE THAT EVEN AT CLOSE TO A ZERO RATE OF ECONOMIC GROWTH, BRITISH IMPORTS OF MANUFACTURED GOODS RISE SUBSTANTIALLY (LAST YEAR IMPORTS OF MANUFACTURES ROSE IN VOLUME BY 11 PERCENT). THE INFERENCE DRAWN BY SOME WAS THAT THE SORT OF MODEST ECONOMIC RECOVERY GENERALLY FORECAST WOULD TOWARD THE END OF 1978 PROVOKE A FLOOD OF IMPORTS. PUTTING THE EXPORT AND IMPORT FEARS TOGETHER, SOME ARRIVED AT THE GLOOMY CONCLUSION THAT ANYTHING MORE THAN A VERY MODEST RATE OF ECONOMIC GROWTH (ONE WHICH WOULD NOT REDUCE UNEMPLOYMENT) WAS INCOMPATIBLE WITH MAINTAINING A CURRENT ACCOUNT SURPLUS, EVEN WITH THE HELP GIVEN BY GROWING NORTH SEA OIL PRODUCTION (AND THIS, IT WAS BELATEDLY NOTED, IS RISING SLOWER THAN PREVIOUSLY PREDICTED).

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3. THE SPECIFIC PERCEPTIONS WE HAVE BEEN RECOUNTING ARE THOSE OF THE MEDIA. THEIR GENERAL PESSIMISM HAS BEEN REFLECTED BY SOME LEADING POLITICIANS, INCLUDING PRIME MINISTER CALLAGHAN. HE IS UNLIKELY TO HAVE BEEN UNDULY SHAKEN BY SOME OF THE DATA RELEASED IN FEBRUARY BUT HE HAS EVIDENTLY FELT GROWING CONCERN THAT THE PROSPECTS FOR AN UPTURN IN THE WORLD ECONOMY (ON WHICH, IN PART, DEPEND THE PROSPECTS FOR BRITAIN'S ECONOMY AND HIS RE-ELECTION) ARE JUST NOT THERE. HE HAS VIRTUALLY PUBLICLY EXPRESSED PROFOUND CONCERN ABOUT THE WORLD ECONOMIC SCENE AND ITS IMPACT ON BRITAIN, AS IN A STATEMENT TO A MEETING OF THE TUC-LABOR PARTY LIAISON COMMITTEE ON FEBRUARY 21.

4. THE BRITISH MEDIA SEEM TO HAVE AN ALMOST UNLIMITED CAPACITY FOR BEING SURPRISED BY THE PREDICTABLE. WHILE IT IS TRUE THAT CERTAIN SIGNS REGARDING THE INTERNATIONAL ECONOMY HAVE TURNED FROM ONE SHADE OF AMBER TO ANOTHER, THE CHANGES HAVE NOT BEEN STARTLING. AND ONE MONTH'S TRADE FIGURES, PARTICULARLY FOR A MONTH WHICH HAS PRODUCED ABERRANT FIGURES IN PREVIOUS YEARS, SHOULD NOT BE

OVER-INTERPRETED, AS THE REBOUND TO A TRADE SURPLUS IN  
FEBRUARY INDICATED. WHAT IS STRIKING IS THE SEEMINGLY  
SUDDEN RE-APPRAISAL OF PROSPECTS BY CALLAGHAN - AFTER  
HAVING LONG PERSISTED IN A MICAWBERISH HOPE THAT A

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SSO-00 USIE-00 INRE-00 /093 W

-----029824 171736Z /43

O R 171552Z MAR 78  
FM AMEMBASSY LONDON  
TO SECSTATE WASHDC IMMEDIATE 4254  
INFO AMEMBASSY PARIS  
AMEMBASSY BONN  
AMEMBASSY BRUSSELS

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WORLD BOOM WOULD BOOST BRITAIN'S ECONOMY.

5. THE MOOD OF THE MEDIA IS AT LEAST ARGUABLY A CLOSER  
REFLECTION OF REALITY THAN ITS PREVIOUS EUPHORIA.  
BRITAIN'S ECONOMY IS HIGHLY OPEN TO THE OUTSIDE WORLD,  
AND HIGHLY DEPENDENT ON IT. NORTH SEA OIL REDUCES THE  
IMPORT BURDEN UNDER WHICH THE BRITISH BALANCE OF PAYMENT  
LABORS, BUT ONLY TO A DEGREE. THE BRITISH DEMAND FOR  
IMPORTS IS APPARENTLY VERY SENSITIVE TO PRESSURES OF  
DOMESTIC DEMAND AND MAY PUT A QUESTION MARK AFTER PRO-  
POSALS FOR RAPID ECONOMIC GROWTH. FINALLY, WHILE  
BRITISH EXPORTS DID WELL IN 1977, THEY WERE AIDED BY A  
WEAK POUND. THE COMBINED EFFECTS OF THE POUND'S  
STRENGTHENING SINCE MID-1977 AND THE CONTINUED INCREASE  
IN BRITISH EXPORT PRICES AT A RATE HIGHER THAN THAT OF  
BRITAIN'S COMPETITORS, HAS ALREADY ERODED BRITAIN'S  
COMPETITIVENESS BY MOST MEASURES. WHEN EARNINGS IN-

CREASES UNDER PHASE 3 BEGIN TO BE PICKED UP BY THE  
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STATISTICS, UNIT LABOR COSTS WILL ALSO BE SEEN TO BE  
LESS FAVORABLE BY COMPARISON WITH BRITAIN'S COMPETITORS.

6. WHAT THIS ALL MEANS IS THAT THERE ARE STRICT LIMITS  
TO THE POSSIBILITIES FOR EXPANDING THE BRITISH ECONOMY  
OVER THE NEXT YEAR. THERE ARE THOSE IN THE BRITISH  
BUREAUCRACY WHO PROBABLY HAVE BEEN QUIETLY WELCOMING  
THE NEWS FROM THE INTERNATIONAL TRADE FRONT BECAUSE IT  
BOLSTERS THE ARGUMENTS THEY HAVE BEEN MAKING ALL ALONG  
FOR RESTRAINT IN FURTHER STIMULATION OF THE ECONOMY.

7. GOVERNMENT LEADERS, HOWEVER, CANNOT TAKE SO COMPLA-  
CENT A VIEW OF THE SITUATION. THE INDICATION THAT  
FUTURE PROSPECTS, DUE TO INTERNATIONAL FACTORS, ARE NOT  
DAZZLING IS A DISTASTEFUL FROSTING TO THE INDIGESTIBLE  
CAKE THAT THE CURRENT INTERNAL ECONOMIC SITUATION CON-  
STITUTES. THERE ARE A FEW BRIGHT ASPECTS, AT LEAST FOR  
THE SHORT TERM. THE INFLATION RATE HAS FALLEN AND  
EARNINGS ARE RISING FASTER THAN PRICES FOR THE FIRST  
TIME IN MANY MONTHS. BUT THERE ARE NO CLEAR SIGNS THAT  
ECONOMIC RECOVERY HAS BEGUN. RETAIL SALES HAVE MOVED UP  
A LITTLE, WHILE INDUSTRIAL PRODUCTION AND THE UNEMPLOY-  
MENT RATE ARE FLAT. THE GOVERNMENT'S CONTRIBUTION TO  
AGGREGATE DEMAND, IN TERMS OF PUBLIC EXPENDITURE, IS  
RUNNING BELOW ANTICIPATED LEVELS. THE CONSIDERABLE  
UNDERSHOOTING OF THE FORECAST PUBLIC SECTOR BORROWING  
REQUIREMENT WILL GIVE CHANCELLOR HEALEY AN OPPORTUNITY  
TO "STIMULATE" THE ECONOMY, MAINLY THROUGH INCOME TAX  
CUTS, PERHAPS TO THE TUNE OF TWO BILLION POUNDS OR SO.  
BUT STRIPPING AWAY THE CLAIMS HE WILL NO DOUBT MAKE ON  
APRIL 11, THE REAL ADDITIONAL STIMULUS TO THE  
ECONOMY IS LIKELY TO BE MODEST. THIS PROSPECT HAS, OF  
COURSE, AROUSED PRESSURE WITHIN THE LABOR PARTY FOR  
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FURTHER STIMULATION, INCLUDING PUBLIC EXPENDITURE IN-  
CREASES CONSIDERABLY LARGER THAN THE MODEST ONES HEALEY  
SEEMS TO BE CONTEMPLATING.

8. THE PURELY DOMESTIC POLITICAL IMPLICATIONS OF ALL  
THIS ARE NOT EASY TO DERIVE. THERE IS LITTLE DOUBT THAT  
OVER THE LAST SIX WEEKS OR SO THE LABOR MOOD HAS  
DARKENED SOMEWHAT, AND THE CONSERVATIVES HAVE BECOME MORE

HOPEFUL. BUT OTHER FACTORS, SUCH AS MRS. THATCHER'S  
SUCCESSFUL AROUSAL OF FEELINGS ABOUT IMMIGRATION AND  
RACE, HAVE PROBABLY HAD AS IMPORTANT AN EFFECT AS THE

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ECONOMIC INDICATORS. SIMILARLY, WHILE ECONOMIC ISSUES  
ARE SIGNIFICANT IN TERMS OF THE DURABILITY OF THE PRESEN  
GOVERNMENT AND ITS CHANCES WHEN AN ELECTION COMES, THEY  
ARE NOT THE ONLY ONES THAT COUNT. THE MOST THAT CAN BE  
SAID AT THIS POINT IS THAT THE GROWING PUBLIC PERCEPTION  
THAT THE NEW JERUSALEM WILL NOT BE BUILT IN 1978 MAY  
LESSEN LABOR'S LEAD AMONG THE POPULACE IN TERMS OF ITS  
ABILITY TO HANDLE MOST KEY ECONOMIC ISSUES.

9. THE INTERNATIONAL IMPLICATIONS ARE SOMEWHAT CLEARER.  
THE BRITISH GOVERNMENT HAS TAKEN A MORE ACTIVE ROLE ON  
INTERNATIONAL ECONOMIC ISSUES, AND HAS MOVED ON FROM THE  
EASILY ADOPTED LINE OF ASKING THAT JAPAN AND GERMANY  
FURTHER STIMULATE THEIR ECONOMIES TO ADVOCATE A "PACKAGE  
DEAL" OF ACTION BY THE U.S. TO STABILIZE THE EXCHANGE  
MARKETS COUPLED WITH REFLATION BY THE SURPLUS COUNTRIES.  
CALLAGHAN'S RECENT TRIPS TO BONN AND HIS FORTHCOMING  
VISIT TO WASHINGTON, WHATEVER THEIR SUBSTANTIVE CONTENT

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OR RESULTS, REFLECT HIS ACTIVE CONCERN THAT THE WORLD'S  
ECONOMY IS NOT PERFORMING ACCORDING TO HIS GAME PLAN -  
AND THAT THIS MEANS TROUBLE FOR BRITAIN AND BRITAIN'S  
GOVERNMENT.

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## Message Attributes

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**Capture Date:** 01 jan 1994  
**Channel Indicators:** n/a  
**Current Classification:** UNCLASSIFIED  
**Concepts:** ECONOMIC CONDITIONS, REPORTS, FOREIGN RELATIONS, INTELLIGENCE ASSESSMENTS, POLITICAL SITUATION  
**Control Number:** n/a  
**Copy:** SINGLE  
**Draft Date:** 17 mar 1978  
**Decaption Date:** 01 jan 1960  
**Decaption Note:**  
**Disposition Action:** RELEASED  
**Disposition Approved on Date:**  
**Disposition Case Number:** n/a  
**Disposition Comment:** 25 YEAR REVIEW  
**Disposition Date:** 20 Mar 2014  
**Disposition Event:**  
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**Review Content Flags:**  
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**Subject:** ECONOMIC CHANGES ALTER POLITICAL MOOD  
**TAGS:** EGEN, PINT, EFIN, UK  
**To:** STATE USOECD MULTIPLE  
**Type:** TE  
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